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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1973

No. 73-512

ALAN F. HUGHES, INC. and
ALAN F. HUGHES,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION
SECURITIES INVESTOR PROTECTION
CORPORATION,

Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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SECURITIES INVESTOR PROTECTION
CORPORATION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

CITATION TO OPINIONS BELOW

Petitioner requests that a writ of certiorari issue to review the decision of the United States Court of Appeals for the Second Circuit made on June 21, 1973.

A copy of the decision is appended hereto per this court's Rule 23(i).

JURISDICTION

Petitioner invokes this court's jurisdiction under this court's Rule 19(b) because the court of appeals has decided an important question of federal law which has not been, but should be, settled by this Court.

(a) The decision and judgment was filed on June 21, 1973 (no time of entry recorded) and the mandate issued on August 30, 1973.

(b) There has been no extension of time within which to petition for certiorari, and no order respecting a rehearing has been requested or entered.

(c) This Court has jurisdiction to review this case pursuant to 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

The questions presented for review, expressed in the terms and circumstances of the case at bar are as follows:

1. Whether failure to provide for payment of reasonable attorney's fees earned in representing a securities broker dealer in a Securities Investor Corporation liquidation application proceeding is arbitrary and capricious and constitutes,

(a) a denial of due process, a denial of assistance of legal counsel, and a denial of equal protection of the law?

(b) is a taking of the attorney's property right in his professional time without just compensation?

(c) is a violation of the Securities Investor Protection Act of 1970 and the Bankruptcy Act?

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

1. United States Constitution, Amendment V:

"No person shall be . . . deprived of life, liberty or property without due process of law. . . ."

2. Statutes:

(a) Pub. Law 91-598, December 30, 1970, 84 STAT. 1637

* * * * *

SEC. 3. SECURITIES INVESTOR PROTECTION CORPORATION.

(a) CREATION.–There is hereby established a body corporate to be known as "Securities Investor Protection Corporation" (hereafter in this Act referred to as "SIPC"). SIPC shall be a nonprofit corporation and shall have succession until dissolved by act of the Congress. SIPC shall–

(1) not be an agency or establishment of the United States Government;

(2) be a membership corporation the members of which shall be–

(A) all persons registered as brokers or dealers under section 15(b) of the 1934 Act, and

(B) all persons who are members of a national securities exchange,

other than persons whose business as a broker or dealer consists exclusively of (i) the distribution of shares of registered open end investment companies or unit investment trusts, (ii) the sale of variable annuities, (iii) the business of insurance, or (iv) the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts; and

(3) except as otherwise provided in this Act, be subject to, and have all the powers conferred upon a nonprofit corporation by, the District of Columbia Nonprofit Corporation Act (D.C. Code, sec. 29-1001 and fol.).

* * * * *

SEC. 4. SIPC FUND.

(a) IN GENERAL.–

(1) ESTABLISHMENT OF FUND.–SIPC shall establish a "SIPC Fund" (hereinafter in this Act referred to as the "fund"). All amounts received by SIPC (other than amounts paid directly to any lender pursuant to any pledge securing a borrowing by SIPC) shall be deposited in the fund, and all expenditures made by SIPC shall be made out of the fund.

* * * * *

(c) ASSESSMENTS.–

(1) INITIAL ASSESSMENTS.–Each member of SIPC shall pay to SIPC, or the collection agent for SIPC specified in section 9(a), on or before the one hundred and twentieth day following the date of enactment of this Act, an assessment equal to one-eighth of 1 per centum of the gross revenues from the securities business of such member during the calendar year 1969, or if the Commission shall determine that, for purposes of assessment pursuant to this paragraph, a lesser percentage of gross revenues from the securities business is appropriate for any class or classes of members (taking into account relevant factors, including but not limited to types of business done and nature of securities sold), such lesser percentages as the Commission, by rule or regulation, shall establish for such class or classes, but in no event less than one-sixteenth of 1 per centum for any such class. In no event shall any assessment upon a member pursuant to this paragraph be less than $150.

(2) GENERAL ASSESSMENT AUTHORITY.–SIPC shall, by bylaw or rule, impose upon its members such assessments as, after consultation with self-regulatory organizations, SIPC may deem

necessary and appropriate to establish and maintain the fund and to repay any borrowings by SIPC.

* * * * *

SEC. 5. PROTECTION OF CUSTOMERS.

(a) DETERMINATION OF NEED OF PROTECTION.–

(1) NOTICE TO SIPC.–If the Commission or any self-regulatory organization is aware of facts which lead it to believe that any broker or dealer subject to its regulation is in or is approaching financial difficulty, it shall immediately notify SIPC, and, if such notification is by a self-regulatory organization, the Commission.

(2) ACTION BY SIPC.–If SIPC determines that any member has failed or is in danger of failing to meet its obligations to customers and that there exists one or more of the conditions specified in subsection (b)(1)(A), SIPC, upon notice to such member, may apply to any court of competent jurisdiction specified in section 27 or 21(e) of the 1934 Act for a decree adjudicating that customers of such member are in need of the protection provided by this Act.

* * * * *

(b) COURT ACTION.–

(1) ISSUANCE OF DECREE.–

(A) FINDINGS BY COURT.–A court to which application is made pursuant to subsection (a)(2) shall grant the application and issue a decree adjudicating that customers of the member named in the application are in need of protection under this Act if it finds that such member–

(i) is insolvent within the meaning of section 1(19) of the Bankruptcy Act, or is unable to meet its obligations as they mature, or

(ii) has committed an act of bankruptcy within the meaning of section 3 of the Bankruptcy Act, or

(iii) is the subject of a proceeding pending in any court or before any agency of the United States or any State in which a receiver, trustee, or liquidator for such member has been appointed, or

(iv) is not in compliance with applicable requirements under the 1934 Act or rules or regulations of the Commission or any self-regulatory organization with respect to financial responsibility or hypothecation of customers' securities, or

(v) is unable to make such computations as may be necessary to establish compliance with such financial responsibility or hypothecation rules or regulations.

* * * * *

(3) APPOINTMENT OF TRUSTEE.—If the court grants an application and makes an adjudication under paragraph (1), the court shall forthwith appoint as trustee for the liquidation of the business of the debtor in accordance with section 6, and as attorney for such trustee, such persons as SIPC shall specify.

* * * * *

SEC. 6. LIQUIDATION PROCEEDINGS.

(a) GENERAL PURPOSES OF LIQUIDATION PROCEEDING.—The purposes of any proceeding in which a trustee has been appointed under section 5(b)(3) (hereafter in this section referred to as a "liquidation proceeding") shall be:

(1) as promptly as possible after such appointment and in accordance with the provisions of this section—

(A) to return specifically identifiable property to the customers of the debtor entitled thereto;

(B) to distribute the single and separate fund, and (in advance thereof or concurrently therewith) pay to customers moneys advanced by SIPC, as provided in subsection (f);

(2) to operate the business of the debtor in order to complete open contractual commitments of the debtor pursuant to subsection (d);

(3) to enforce rights of subrogation as provided in this Act; and

* * * * *

(4) to liquidate the business of the debtor.

(b) POWERS AND DUTIES OF TRUSTEE.–

'(1) TRUSTEE POWERS.–A trustee appointed under section 5(b)(3) (hereinafter referred to as "trustee") shall be vested with the same powers and title with respect to the debtor and the property of the debtor, and the same rights to avoid preferences, as a trustee in bankruptcy and a trustee under chapter X of the Bankruptcy Act have with respect to a bankrupt and a chapter X debtor. In addition, a trustee shall have the right–

(A) with the approval of SIPC, to hire and fix the compensation of all personnel (including officers and employees of the debtor and of its examining authority) and other persons (including but not limited to accountants) that are deemed by such trustee necessary for all or any purposes of the liquidation proceeding, and

(B) to operate the business of the debtor in order to complete open contractual commitments pursuant to subsection (d),

and no approval of the court shall be required therefor.

(2) TRUSTEE DUTIES.–Except as inconsistent with the provisions of this Act or otherwise ordered by the court, a trustee shall be subject to the same duties as a trustee appointed under section 44 of the Bankruptcy Act, except that a trustee may, but shall have no duty to, reduce to money any securities in the single and separate fund (provided under subsection (c)(2)(B)) or in the general estate of the debtor.

(c) APPLICATION OF BANKRUPTCY ACT.–

(1) GENERAL PROVISIONS APPLICABLE. –Except as inconsistent with the provisions of this Act and except that in no event shall a plan of reorganization be formulated, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under, the provisions of chapter X and such of the provisions (other than section 60e) of chapters I to VII, inclusive, of the Bankruptcy Act.

Bankruptcy Act of July 1, 1898, As Amended

Section 60(a)(1), 11 U.S.C. 96(a)(1):

"A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class."

Section 60(d), 11 U.S.C. 96(d):

"If a debtor shall, directly or indirectly, in contemplation of the filing of a petition by or against him, pay money or transfer property to an

attorney at law, for services rendered or to be rendered, the transaction may be examined by the court on its own motion or shall be examined by the court on petition of the trustee or any creditor and shall be held valid only to the extent of a reasonable amount to be determined by the court, and any excess obligation shall be canceled, or if excess payment or transfer has been made, return to the bankrupt."

Section 64(a), 11 U.S.C. 104(a):

"The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates . . . shall be (1) . . . one reasonable attorney's fee, for professional services actually rendered, irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases . . . in such amount as the court may allow . . ."

STATEMENT OF THE CASE

On August 18, 1971, the Securities and Exchange Commission ("SEC") filed in the United States District Court for the Northern District of New York a complaint for injunction and appointment of a receiver and an application for a temporary restraining order against Alan F. Hughes, Inc. ("Hughes, Inc."), a small registered securities broker-dealer and Alan F. Hughes ("Hughes"), its principal officer and shareholder. The complaint charged that the firm, aided and abetted by Hughes, had violated provisions of the Securities Exchange Act of 1934, and bookkeeping, hypothecation, net capital and anti-fraud rules thereunder. The application for temporary restraining order which, *inter alia*, froze the firms assets was granted on August 20, 1971.

On September 7, 1971 defendants consented to permanent injunction. On the same day, the court heard oral argument on the SEC's motion for appointment of a receiver. The District Court denied the motion at that time, and instead, appointed a Special Fiscal Agent ("SFA"), to take control of Hughes, Inc., examine its books and report back on whether there was a need to appoint a receiver or to liquidate the firm.

On October 27, 1971, the SFA filed an extensive report recommending the appointment of a receiver and the liquidation of the firm.

After further briefing and oral argument, the District Court, by order of December 13, 1971, appointed a receiver "until such time as . . . the Securities Investor Protection Corporation makes a determination whether to install its own trustee pursuant to Section 5(a)9(2) of the 1970 Act . . . and a trustee is so installed."

On January 10, 1972 SIPC applied to the District Court for an order adjudicating the customers of Hughes, Inc. to be in need of protection, and appointing a trustee to liquidate the firm. On January 17, 1972, after briefing and oral argument, the District Court granted the application and appointed a trustee for the liquidation of the firm pursuant to Section 5(b)(3) of the 1970 Act.

Motion for reconsideration, after briefing and oral argument, was denied by order of February 10, 1972. Motion for stay pending appeal was denied by the District Court on February 22, 1972.

On the same day, motion for stay pending appeal was filed in this Court. Oral argument was set for February 29, 1972. After argument and consideration of the Court's observations. SIPC agreed that its trustee would refrain from liquidating the firm during the pendency of the appeal. Briefs were filed on an expedited basis and

oral argument was heard at an early date on March 10, 1972. The Court rendered its decision sustaining appointment of the receiver and the SIPC trustee on April 21, 1972.

Motion for provision for payment of attorney's fees as a matter of first priority from the estate of Hughes, Inc. and/or from SIPC funds was filed in the District Court on July 11, 1972. That motion also sought leave for counsel to withdraw (except for purposes of pursuing an appeal of the denial) in the event the principal relief was not granted. SIPC opposed the motion and questioned the right of counsel to retain the portion of fees and expenses that had been paid. Total fees and expenses of $7,117.26 were unpaid, due and owing. Billing was at the rate of $35.00 per hour. Payments totalling $2,118.86 had been made.

After hearing oral argument, the District Court issued its order dated August 11, 1972, denying the application for fees, upholding retention of legal fees that had been paid and granting counsel leave to withdraw except for the purpose of appealing that order.

Notice of Appeal was filed September 11, 1972, and the case was decided on June 21, 1973, as referred to hereinabove.

John B. Donohue, Jr., Counsel of record, was an employee of Shipley, Akerman, Stein & Kaps, counsel of record in the case, and acted in behalf of and for that office. All of the above proceedings involved substantial time, expense, and overhead in behalf of Hughes, Inc. and Mr. Hughes, its principal. Carl L. Shipley, acting for his office, is the petitioner herein.

REASONS FOR GRANTING THE WRIT

The court of first instance had jurisdiction herein pursuant to the Securities Investor Protection Act of 1970, cited hereinabove.

ARGUMENT

Petitioner makes the following contentions in support of his petition for a writ of certiorari:

In *SEC v. Alan F. Hughes, Inc.*, 461 F.2d 974, the second circuit characterized the litigation as,

> "... this case of first impression under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa, et seq.)."

Petitioner's office rendered valuable legal services to the court in that proceeding in the capacity of counsel for the appellants.

Exercising authority under the 1970 Act, the Securities Investor Protection Corporation initiated proceedings which led to the appointment of a trustee and liquidation of appellant's business as a securities broker dealer. In this connection, all of the assets of appellant were seized. He was left without any funds to pay counsel for services in the proceeding.

The District Court denied petitioner's application for attorney's fees, and the court of appeals affirmed that decision. In so doing, the court of appeals decided an important question of federal law which has not been, but should be, settled by this court, i.e. that a securities broker dealer against whom the SIPC or SEC initiate liquidation proceedings cannot have from his assets funds with which to pay reasonable attorney's fees in protecting his statutory and constitutional rights.

If that is the settled law under the Securities Investor Protection Act of 1970, then the Act unconstitutionally denies to broker dealers against whom liquidation proceedings are initiated by SIPC the effective assistance of counsel of his choice. Without prospect of payment, no lawyer will represent such a client, and the court will be deprived of the assistance of counsel. The adversary system of judicial proceedings developed under the federal constitution implicitly assumes there will be legal counsel on each side. If a broker dealer who is the target of SIPC liquidation application proceedings can be deprived of means to hire a lawyer, his right of due process is significantly abridged.

The court of appeals in the decision below said in pertinent part:

> "... the Constitution ... does not require that a brokerage firm resisting an application under SIPC be entitled to have its attorneys paid out of the estate."

That statement is the equivalent of saying that in such proceedings the target broker dealer is not entitled to legal counsel in a proceeding that may result in the liquidation of his business, the destruction of his means of livelihood, and the loss of his good name and business reputation. It is difficult to imagine that Congress intended to give to SIPC the unilateral, ex parte power to wreak such havoc on target broker dealers without the check and balance of counsel to resist in behalf of the broker dealer. Such a concept, that an agency of government can have such unfettered and unchallengable power, is at war with the basic concepts of fair play this court has so often found in the federal constitution.

The court below ignores that there are two sources from which a respondent's legal counsel can be paid, i.e.

that liquidation estate, or the SIPC fund which the dues of respondent help create as provided in Section 4(c) of the SIPC Act.

The court can take notice in the record that the court-appointed trustee paid himself very substantial fees as a liquidator, with SIPC concurrence. But both the trustee and the SIPC strongly resisted petitioner's application for counsel fees for services rendered to the respondent broker dealer in the same proceeding. This is raw abuse of power and discretion, it is an arbitrary and capricious deprivation of the respondent's right to counsel, and in this case, it is tantamount to a taking of petitioner's property right in his professional time spent on this case without just compensation.

The court below cites no case in this court on this point, and the question should be settled. The SIPC Act of 1970 is a novel departure in that it seems to authorize a pre-bankruptcy liquidation of a securities broker dealer's business upon a "decree adjudicating that customers of such a member are in need of protection" (Section 5(a)(1)(3) of the 1970 Act).

Standing alone, that is an astonishing proposition, particularly when one reads Section 5(b)(1)(A) of the 1970 Act and finds that liquidation can take place without any determination of insolvency—simply on grounds of being the subject of a "pending proceeding" in which a receiver or trustee has been appointed (Section 5(b)(1)(A)(iii)), or a finding that the respondent broker dealer is not in "compliance with applicable requirements under the 1934 Act or rules or regulations of the Commission [SEC]. . . with respect to financial responsibility or hypothecation of customers securities" (Section 5(b)(1)(A)(iv)), or even on a finding that he is "unable to make such computations as may be necessary to establish compliance." (Section 5(b)(1)(A)(v)).

It is submitted that these three above-cited statutory bases for liquidation may have nothing to do with insolvency, or customer protection. It has been demonstrated before Committees of Congress that the SEC itself cannot twice in a row follow its own complicated net capital computation rule. In short, if Congress intended in the 1970 Act that these types of findings would be made against a respondent in a judicial proceeding where his funds have been impounded and he cannot employ competent legal counsel, then Congress has violated the constitutional guarantee of due process and equal protection.

The court's attention is directed to the statement in the decision below that:

> ". . . we do not understand the law to be that, as a general matter, the Constitution requires the appointment of counsel for litigants in civil cases. . . ."

That would hardly seem to be a correct statement of the law in a case where a quasi-government agency, the SIPC, has such penalty and forfeiture powers as total liquidation of a business for inability to compute net capital. The citations relied upon by the court below in footnote 5 of it's decision do not reflect that this court has settled that question, certainly not in so far as the SIPC Act of 1970 is concerned. If that is the law, then it is wrong and should be reconsidered by this court.

In any event, there are over 4,700 securities broker dealers in the U.S., most of whom are being assessed dues by SIPC, in which they are compelled by the Act to be members (SEC 38th Annual Report – 1972, p. 148), who have combined income of over $5 billion per year (supra, p. 147), and equity capital of nearly $10 billion. That is too large an investment to permit to be liquidated

on the iniative of the SIPC, against respondent broker dealers deprived of effective assistance of legal counsel.

Since the SIPC Act of 1970 will be with us from now on, and each year it can be anticipated there will be numerous liquidation proceedings (in its 1972 Annual Report, SIPC shows last year 64 firms in 21 states in liquidation), this court should settle the question of whether a target respondent is entitled to have reasonable attorney's fees in liquidation proceedings paid from his estate or the SIPC fund his assessments helped create. It is indeed a paradox that a respondent's assets or estate can be used to pay a court-appointed (SIPC selected) liquidator and his lawyers and accountants, and that liquidator and the SIPC can deny to respondent a use of his own funds or the benefit of SIPC funds to hire a lawyer.

The basic flaw in the decision of the court below is its conclusion that neither subsection 6(b)(1)(A) of the 1970 Act nor section 60d of the Bankruptcy Act permit payment of reasonable attorney's fees for a respondent. As to the SIPC Act of 1970 the court says that "the legal services in question do not fit into any of these categories" referring to overall provisions of that section. Similarly the court below disposes of section 60d of the Bankruptcy Act with similar dispatch concluding that it "is not a grant of authority to pay counsel fees." Petitioner respectfully submits that this cavalier approach by the court below raises questions of federal law which should be settled by this court in order that future liquidations under the SIPC Act of 1970 can proceed in an orderly way and within the constitutional safeguards of the adversary system.

CONCLUSION

Wherefore, it is respectfully requested that a writ of certiorari issue to the United States Court of Appeals for the Second Circuit to review its decision of June 21, 1973, referred to hereinabove.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 636—September Term, 1972.

(Argued May 29, 1973 Decided June 21, 1973.)

Docket No. 72-2166

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

SECURITIES INVESTOR PROTECTION CORPORATION,

Applicant-Appellee,

—against—

ALAN F. HUGHES, INC. and ALAN F. HUGHES,

Defendants-Appellants.

Before:

MOORE, FRIENDLY and FEINBERG,

Circuit Judges.

Appeal from denial in United States District Court for the Northern District of New York, James T. Foley, *Ch.J.*, of application for counsel fees on behalf of attorneys representing broker-dealer in SIPC-initiated liquidation proceedings.

Affirmed.

JOHN BARRY DONOHUE, JR., Washington, D.C. (Shipley Akerman, Stein & Kaps, on the brief), *for Defendants-Appellants.*

WILFRED R. CARON, Associate General Counsel (Theodore H. Focht, General Counsel, Francis L. Carter, Attorney, on the brief), *for Appellee Securities Investor Protection Corporation.*

WINTHROP J. ALLEGAERT, New York, N.Y., *for Trustee.*

FEINBERG, *Circuit Judge:*

In August 1971, the Securities and Exchange Commission (SEC) filed a complaint in the United States District Court for the Northern District of New York alleging that Alan F. Hughes, Inc., a registered broker-dealer, aided and abetted by its president, Alan F. Hughes, had violated various provisions of the Securities Exchange Act of 1934. The complaint sought an injunction and appointment of a receiver. This relief was granted. Thereafter, the Securities Investor Protection Corporation (SIPC) determined that Hughes, Inc. was in danger of failing to meet its obligations to its customers and that there existed one or more of the conditions specified by section 5(b)(1)(A) of the Securities Investor Protection Act of 1970 (the 1970 Act), 15 U.S.C. § 78eee(b)(1)(A). In January 1972, Chief Judge James T. Foley, agreeing with SIPC's conclusions, granted its application for appointment of a trustee for liquidation of Hughes, Inc. under the 1970 Act.[1] The application by SIPC was hotly contested both in the district court and on appeal to this court on a number of grounds.

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1 Section 5(b)(3) of the 1970 Act, 15 U.S.C. § 78eee(b)(3).

The decision of this court, with which familiarity will be assumed, was the first to interpret the 1970 Act in a number of important respects. *SEC* v. *Alan F. Hughes, Inc.*, 461 F.2d 974 (2d Cir. 1972). Among other things, we held that a broker-dealer resisting an application by SIPC for liquidation is entitled to a de novo judicial determination that "the broker-dealer has failed or is in danger of failing to meet its obligations to its customers." 461 F.2d at 979.

So much is prologue to this proceeding, in which counsel for defendants in the prior litigation claim that for their services in resisting the SIPC application they are entitled to attorneys fees[2] as a matter of first priority from the estate of Hughes, Inc. or from SIPC funds, or from both. Their fee application was denied by Judge Foley on the ground that there was no legal basis for allowing such a fee,[3] and this appeal followed. Appellants argue that the 1970 Act and the Bankruptcy Act both authorize the compensation requested and that failure to so construe these Acts denies due process of law to those against whom SIPC proceeds, and is arbitrary, capricious and a denial of the equal protection of the laws.

The 1970 Act

In pressing their claim for compensation, appellants rely upon subsection 6(f)(2) of the 1970 Act, 15 U.S.C. § 78fff(f)(2), which provides that in addition to advancing funds for claims of customers against the broker-dealer being liquidated, "SIPC may advance to the trustee such

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2 The attorneys are seeking $7,117.26 in unpaid fees and expenses.

3 Judge Foley, however, did allow counsel to retain payments of $2,118.86 previously received from defendants for legal fees and expenses, and granted counsel's application to be relieved except to pursue this appeal.

moneys as may be required to effectuate subsection (b)(1)(A) of this section." Subsection 6(b)(1)(A) sets forth the powers of a trustee under the 1970 Act, which include the power, with SIPC approval, to

> hire and fix the compensation of all personnel . . . and other persons (including but not limited to accountants) that are deemed by such trustee necessary *for all or any purposes of the liquidation proceeding.* . . . [Emphasis added.]

Appellants argue that since this court held in its prior opinion that a de novo judicial hearing is an integral aspect of an SIPC liquidation proceeding, one of the "purposes" of that proceeding must be to give a broker-dealer a chance to show that the claims against it are insufficient or incorrect. For legal services in that endeavor, they claim the 1970 Act thus clearly authorizes compensation. However, this argument confuses a defendant's rights at an SIPC hearing with the congressionally-defined powers of an SIPC trustee. Section 6(a) of the 1970 Act, 15 U.S.C. § 78fff(a), enumerates the "purposes of the liquidation proceeding" to which subsection 6(b)(1)(A) refers. These are to return specifically identifiable property to the debtor's customers, to pay customers, to operate the debtor's business in order to complete open contractual commitments, to enforce rights of subrogation, and to liquidate the debtor's business. The legal services in question do not fit into any of these categories. Appellants' argument in its simplest form is that resisting liquidation is a purpose of the liquidation proceeding. While Congress could so provide, we do not believe that it has.

Appellants also argue that unless we accept their construction of the 1970 Act, respondents to SIPC liquidation applications will be unconstitutionally deprived of the as-

sistance of counsel. Appellants point out that the SEC and SIPC frequently act in tandem to tie up a firm's assets pending judicial determination of the application for a trusteeship and liquidation,[4] and argue that counsel will not undertake a defense without assurance of subsequent payment. Defendants obviously suffered no deprivation of legal services here, and the same willingness of attorneys to represent a debtor resisting involuntary proceedings under the Bankruptcy Act is a frequent phenomenon. Quite apart from the observation that we do not understand the law to be that, as a general matter, the Constitution requires the appointment of counsel for litigants in civil cases,[5] the analogy to the Bankruptcy Act is compelling. We have long held that legal services in resisting a bankruptcy petition are not compensable under that Act, see, e.g. *In re Evenod Perfumer, Inc.*, 67 F.2d 878 (2d Cir. 1933), cert. denied, 291 U.S. 671 (1934), and it has not been seriously doubted that this interpretation is constitutional. Moreover, if the Constitution does not require exemption from a filing fee for an indigent who seeks to take advantage of the bankruptcy laws, see *United States* v. *Kras*, 409 U.S. 434 (1973), it surely does not require that a brokerage firm resisting an application under SIPC be entitled to have its attorneys paid out of the estate.

The Bankruptcy Act

Appellants also rely upon sections 60d and 64a of the Bankruptcy Act, 11 U.S.C. §§ 96(d), 104(a), both of which,

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4 SIPC First Annual Report, 1971, pp. 22-23.

5 See, e.g., *Peterson* v. *Nadler*, 452 F.2d 754, 757 (8th Cir. 1971) (per curiam); *Bethea* v. *Crouse*, 417 F.2d 504, 505 (10th Cir. 1969); cf. *United States ex rel. Gordon* v. *Reincke*, 415 F.2d 1126, 1128 (2d Cir. 1969) (per curiam). But see Note, The Right to Counsel in Civil Litigation, 66 Colum. L. Rev. 1322 (1966). We do of course recognize that a federal district judge is given discretion to appoint counsel in civil cases pursuant to the salutary provisions of 28 U.S.C. § 1915(d).

under section 6(c)(1) of the 1970 Act, 15 U.S.C. § 78fff (c)(1), apply to SIPC liquidations. Section 64a gives a first priority claim against the estate of the debtor for

> one reasonable attorney's fee . . . irrespective of the number of attorneys employed, to the bankrupt in voluntary and involuntary cases . . . in such amount as the court may allow.

Appellants concede that the cases take a narrow view of the protection offered attorneys' fees by section 64, limiting compensation to services that "aid in the administration of the estate." Despite the authority that resisting a bankruptcy application does not so "aid" the estate, see *In re Evenod Perfumer, Inc.*, supra; 3A Collier on Bankruptcy ¶ 62.31[4] (14th ed. 1972), appellants argue that in the context of an SIPC liquidation the section should be construed differently to allow compensation for such services. The reasons given for distinguishing the two situations are that an SIPC proceeding is initiated by a public, not a private, body; that the proceeding may commence even though the broker-dealer may be solvent; and that allowing such attorneys' fees could greatly reduce the amount available for creditors in a straight bankruptcy proceeding, but would not affect the moneys going to broker-dealer customers in an SIPC proceeding.

The first of these arguments is, in this context, a distinction without a difference. The second is no distinction at all, since a creditor petitioning in bankruptcy and SIPC seeking a liquidation may each err in their allegations. Perhaps appellants' point is that SIPC may base a petition upon "technical" violations, such as bookkeeping deficiencies or an inability to meet net capital requirements,[6] whereas a creditor in straight bankruptcy must allege some-

6 See 15 U.S.C. § 78eee(b)(1)(A).

thing more substantial. The two-fold answer is that "technical" violations under the 1970 Act are frequently most significant, and, in any event, an SIPC liquidation cannot be ordered unless the court finds that the broker-dealer has failed or is in danger of failing to meet its obligations to its customers, surely not just a "technical" matter. The final point is the only one that gives pause at all—although not for long. It may be true that allowing fees to the attorneys for defendants in an SIPC proceeding would not reduce the fund available for most broker-dealer customers.[7] But it still does not follow that, when incorporating section 64a into the 1970 Act "[e]xcept as inconsistent with the provisions of" the Act, 15 U.S.C. § 78fff(c)(1), Congress intended to exclude well-settled judicial interpretations of that section.

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7 Customers of a broker-dealer with claims outstanding are entitled to share ratably in the "single and separate fund," composed of property held by the firm for customer accounts but not identified to a specific customer (specifically identifiable property is returned to the customer if he is entitled to it). 15 U.S.C. § 78fff(c)(2)(B), (C). If distribution of the fund leaves some claims still partially unsatisfied, SIPC is authorized to advance to the trustee funds for payment of the remaining customer claims up to $50,000 per account, except that no more than $20,000 per account will be advanced to cover claims for cash. 15 U.S.C. § 78fff(f)(1). If a customer's claim is still not fully satisfied, he can share in the general estate of the firm with the general creditors. Thus, unless a customer, because of his firm's inability to meet its obligations, faces a loss (after taking into account his share of firm assets) nearly as great as the maximum coverage provided by SIPC, there is no likelihood that diminution of the estate by payment of a priority claim to the firm's attorneys will reduce the customer's recovery. It should be noted, however, that while most customers are thus fully protected, a minority of large investors could face substantial losses in spite of SIPC's coverage. See Sowards & Mofsky, The Securities Investor Protection Act of 1970, 26 Bus. Law. 1271, 1283-84 n.60 (1971). Furthermore, to the extent that a priority claim for attorneys' fees would reduce the general estate, the rights of general creditors would be adversely affected. For an evaluation of the early performance of SIPC, see Note, The Securities Investor Protection Act of 1970: An Early Assessment, 73 Colum. L. Rev. 802 (1973).

Appellants' argument based upon section 60d of the Bankruptcy Act requires little discussion. That provision, reproduced in relevant part in the margin,[8] is not a grant of authority to pay counsel fees, as appellants suggest, but rather a vehicle for protecting estates against payment by a debtor of an excessive legal fee; the section permits attorneys to retain compensation only to the extent of reasonable value of services rendered before the filing of a bankruptcy petition and is not authority for allowance of fees for services after filing. See 3 Collier on Bankruptcy ¶ 60.68, at 1143 (14th ed. 1971). On this view, there is no basis for appellants' claim that the section authorizes payment of counsel fees for work done after the filing of the petition and that it is therefore arbitrary to treat such services differently, depending on whether the fee is paid before or after the filing. In any event, such distinctions based upon arbitrary dates abound in the Bankruptcy Act,[9] and they are not unconstitutional.

Judgment affirmed.

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8 If a debtor shall . . ., in contemplation of the filing of a petition . . ., pay money or transfer property to an attorney at law, for services rendered or to be rendered, the transaction may be examined by the court on its own motion or shall be examined by the court on petition of the trustee or any creditor and shall be held valid only to the extent of a reasonable amount to be determined by the court, and the excess may be recovered by the trustee for the benefit of the estate.

If, whether before or after filing, a debtor shall agree orally or in writing to pay money or transfer property to an attorney at law after the filing, the transaction may be examined by the court on its own motion or shall be examined by the court on petition of the bankrupt made prior to discharge and shall be held valid only to the extent of a reasonable amount . . ., and any excess obligation shall be cancelled, or . . . returned to the bankrupt.

9 E.g., 11 U.S.C. § 96(a)(1) (preference is transfer "to or for the benefit of a creditor . . . within four months before the filing" of bankruptcy petition).

SUPREME COURT, U.S.
OCT 19 1973
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-512

ALAN F. HUGHES, INC. and ALAN F. HUGHES,

Petitioner,

—v.—

SECURITIES INVESTOR PROTECTION CORPORATION
SECURITIES AND EXCHANGE COMMISSION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION OF RESPONDENT SECURITIES INVESTOR PROTECTION CORPORATION

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-512

ALAN F. HUGHES, INC. and ALAN F. HUGHES,

Petitioner,

—v.—

SECURITIES INVESTOR PROTECTION CORPORATION
SECURITIES AND EXCHANGE COMMISSION,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION OF RESPONDENT SECURITIES INVESTOR PROTECTION CORPORATION

Opinion Below

The opinion of the Court of Appeals is reported as *Securities and Exchange Commission* v. *Alan F. Hughes, Inc.*, 481 F.2d 401 (2d Cir. 1973).[1]

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[1] Respondent Securities and Exchange Commission did not participate in the appeal to the Court of Appeals.

Jurisdiction

Respondent Securities Investor Protection Corporation ("SIPC") does not contest the the jurisdiction of this Court.

Constitutional Provisions and Statutes Involved

The petition sets forth Section 6(b)(1)(A) of the Securities Investor Protection Act of 1970 ("1970 Act") [15 U.S.C. § 78fff(b)(1)(A)]. The petition omits reference to Section 6(f) of the 1970 Act [15 U.S.C. § 78fff(f)] which limits the use of SIPC's funds to advances for customer claims [subdivision (1)], and provides in subsection (2):

> "Other advances.—SIPC may advance to the trustee such moneys as may be required to effectuate subsection (b)(1)(A). SIPC shall advance to the trustee such moneys as (with those available pursuant to subsection (d)) may be required to effectuate subsection (d)."

The petition also appears to rely on a portion of Section 60d of the Bankruptcy Act (11 U.S.C. § 96d) but misquotes approximately the last three lines. Section 60d provides, in pertinent part:

> "If a debtor shall, directly or indirectly, in contemplation of the filing of a petition by or against him, pay money or transfer property to an attorney at law, for services rendered or to be rendered, the transaction may be examined by the court on its own motion or shall be examined by the court on petition of the trustee or any creditor and shall be held valid only to the extent of a reasonable amount to be determined by the court, and the excess may be recovered by the trustee for the benefit of the estate."

The erroneously quoted portion in the petition does not appear material to the issues presented.

This is the first occasion upon which the 1970 Act has come before this Court for review. To assist the Court there is annexed an Appendix which summarizes the history, purposes and provisions of the 1970 Act as well as the structure, role and authority of SIPC thereunder. To some extent this brief assumes familiarity with that Appendix.

Questions Presented

This respondent respectfully submits there is no substantial question of federal constitutional law properly presented in the circumstances of this case, and that the sole issue properly tendered by the petition is whether the 1970 Act or the Bankruptcy Act authorizes the use of assets of Alan F. Hughes, Inc. ("Debtor") or SIPC's funds to pay petitioner for services rendered to the Debtor in unsuccessfully resisting liquidation under the 1970 Act.

Statement of the Case

Petitioner's statement of the case is substantially correct, but it should be augmented as follows. Although the petition so implies, it is the undisputed fact that the petitioner's services were rendered solely in unsuccessfully resisting the Debtor's liquidation under the 1970 Act. Those efforts culminated in an earlier decision by the Court of Appeals that the 1970 Act as applied to the Debtor did not deprive it of its property without due process of law. *Securities and Exchange Commission* v. *Alan F. Hughes, Inc.*, 461 F.2d 974 (2d Cir. 1972).

The petition implies (at page 12) that Mr. Hughes, the principal of the Debtor in liquidation, " . . . was left without any funds to pay counsel for services in the proceeding." Nothing appears in this record concerning Mr. Hughes' personal finances. Moreover this proceeding was for the purpose of liquidating this corporate Debtor, not for the purpose of administering Mr. Hughes' personal estate.

REASONS FOR DENYING THE WRIT

I.

Neither the 1970 Act nor the Bankruptcy Act authorizes compensation for the petitioner's services.

The petition charges the Court of Appeals with a "cavalier approach" (Petition, page 16) and asserts that "[t]he court below ignores that there are two sources from which a respondent's legal counsel can be paid, *i.e.*, the liquidation estate or the SIPC fund . . . ." (Petition, page 14). Neither statement is warranted, as the opinion of the Court of Appeals amply demonstrates. While this respondent relies upon the succinct and cogent unanimous opinion of the Court of Appeals, some further comment may be useful to this Court.

The 1970 Act

The Court of Appeals properly refused to torture the words and intent of Sections 6(f)(2) and 6(b)(1)(A) of the 1970 Act [15 U.S.C. §§ 78fff(f)(2) and (b)(1)(A)] so as to extract authority to pay petitioner's legal fees. The obvious design of these provisions, to the extent pertinent, is to advance funds to the trustee in carrying out the purposes of the proceeding. The Court of Appeals was clearly cor-

rect in holding that resisting liquidation is not a specified or reasonably inferred purpose of the proceeding.

The statute involved is unambiguous and requires no construction. See, *e.g., Callanan* v. *United States,* 364 U.S. 587, 596 (1961). Had Congress intended the result sought by petitioner, " . . . we can hardly suppose that it would have failed to use some appropriate language to express that intention." *Shamrock Oil and Gas Corp.* v. *Sheets,* 313 U.S. 100, 107 (1941). Whatever may be the remote constitutional implications (*infra,* page 11), this clear statutory language as applied in this case does not present a question which ought to be reviewed by this Court. If the Court of Appeals rejected petitioner's contention with "dispatch" (Petition, page 16), the ease of resolving the issue resulted from the petitioner's untenable distortion of statutory language and not from a "cavalier" judicial attitude.

Bankruptcy Act—Section 64a(1)

Section 6(c)(1) of the 1970 Act [15 U.S.C. § 78fff(c)(1)] makes certain sections of the Bankruptcy Act applicable to SIPC liquidations, including Section 64a(1) [11 U.S.C. § 104a(1)]. Unlike Section 6(b)(1)(A) of the 1970 Act, Section 64a(1) does provide for the compensation of debtors' attorneys when appropriate. As the Court of Appeals observed (pages 403-404), the petitioner conceded that all the cases construing Section 64a(1) limit compensation to services that aid in the administration of the estate, and deny compensation for services rendered in resisting bankruptcy.

The pertinent provision in Section 64a(1) has remained substantially unchanged since the Bankruptcy Act of 1898. 3A COLLIER ON BANKRUPTCY, ¶62.31[1], pp. 1596-1599 (14th

ed. 1972). Its predecessor was Section 64b(3). The universally accepted construction of this provision, as summarized by the Court of Appeals, has its roots in Justice Holmes' opinion in *Randolph* v. *Scruggs*, 190 U.S. 533, 538-540 (1903) and Chief Justice Hughes' opinion in *Conrad, Rubin & Lesser* v. *Pender*, 289 U.S. 472, 476 (1933). See 3A COLLIER, *op. cit. supra*, ¶ 62.05[2], p. 1431. It is now well settled that a bankrupt's attorney may only be compensated for services which either (a) confer a direct pecuniary benefit upon the estate, or (b) aid the administration of the estate usually in connection with the bankrupt's duties under Section 7 of the Bankruptcy Act [11 U.S.C. § 25]. See, *e.g.*, *In Re Schumaker Construction, Inc.*, 346 F.2d 353, 355 (7th Cir. 1965); *Lewis* v. *Fitzgerald*, 295 F.2d 877 (10th Cir. 1961), *cert. denied*, 369 U.S. 828 (1962); *In Re Munford*, 255 Fed. 108, 115 (E.D.N.C. 1919); *In re Mayer*, 101 Fed. 695, 696 (E.D. Wisc. 1900); *In re Michel*, 95 Fed. 803 (E.D. Wisc. 1899); *In re Colonial Distributing Company*, 314 F. Supp. 418 (D.S.C. 1970); *In re Eastwood*, 239 F. Supp. 847, 848 (D. Ore. 1965); *In re New York Investors, Inc.*, 48 F. Supp. 900 (E.D.N.Y.), *aff'd*, 138 F.2d 881 (2d Cir. 1943); *In re Herald-Post, Inc.*, 21 F. Supp. 231 (W.D. Ky. 1937); *In re Owl Drug Co.*, 16 F. Supp. 139 (D.Nev. 1936), *aff'd*, 90 F.2d 823 (9th Cir. 1937); *In re Evenod Perfumer, Inc.*, 4 F. Supp. 916 (S.D.N.Y.), *aff'd*, 67 F.2d 878 (2d Cir.), *cert. denied*, 291 U.S. 671 (1933).

Under the foregoing rule various non-conforming services have been held not compensable. See 3A COLLIER, *op. cit. supra*, ¶62.31[4], p. 1610. Among those are services rendered resisting bankruptcy, the noncompensable character of which was first established by this Court in *Randolph* v. *Scruggs, supra* at 539-540. Research has dis-

closed no exception to this rule. See, *e.g., In re Munford, supra* at 115; *In re M. Zier & Co.,* 142 Fed. 102, 104 (7th Cir. 1905), *aff'g* 127 Fed. 399 (D.Ind. 1904); *In re Garrett Road Corp.,* 256 F. Supp. 709, 712-713 (E.D.Pa. 1966); *In re Owl Drug Co., supra* at 147; *In re Rothman,* 14 F. Supp. 241, 243 (S.D.N.Y.), *aff'd,* 85 F.2d 51 (2d Cir. 1936); *In re Evenod Perfumer, Inc., supra* at 917.

Bankruptcy Act—Section 60d

The Court of Appeals quite properly gave Section 60d (11 U.S.C. § 96d) the meaning required by its unambiguous terms. The petitioner makes no attempt to demonstrate error. Brief comment seems appropriate to show that the holding of the Court of Appeals is not only correct but also reflects well-established law.

The relevant portion of Section 60d has remained substantially unchanged since its adoption as part of the Bankruptcy Act of 1898. *Conrad, Rubin & Lesser* v. *Pender,* 289 U.S. 472 (1933); *In re Wood,* 210 U.S. 246 (1907). As this Court observed in the *Wood* case (at page 253) Section 60d was a *sui generis* measure designed to protect against the tendency of failing debtors to enter into improvident legal retainers in times of financial difficulty. Hence Section 60d is not a grant of authority to pay counsel fees for services rendered after bankruptcy, but rather a vehicle for protecting bankrupt estates by subjecting all legal fees paid for services in contemplation of bankruptcy to judicial scrutiny. *In re Louisiana Loan and Thrift Corp.,* 416 F.2d 898, 900-901 (5th Cir. 1969), *cert. denied,* 397 U.S. 912 (1970); *Bass* v. *Olsen,* 378 F.2d 818 (9th Cir. 1967); *In re Buchanan,* 66 F.2d 416 (2d Cir. 1933); *In re Falk,* 30 F.2d 607 (2d Cir. 1929); *In re Rolnick,* 294 Fed. 817 (2d Cir.

1923); *In re Autocue Sales & Dist. Corp.*, 167 F. Supp. 672 (S.D.N.Y. 1958); *In re Knickerbocker Leather & Novelty Co.*, 158 F. Supp. 236 (S.D.N.Y. 1958), *aff'd*, 265 F.2d 219 (2d Cir. 1959). Section 60d only permits the retention of reasonable fees actually paid. Unpaid fees for services rendered before bankruptcy can only be claimed by the attorney as a general creditor. See *Bass* v. *Olsen, supra.* Section 60d has been held constitutional. *Davis* v. *Negin*, 357 F.2d 154 (6th Cir.), *cert. denied*, 385 U.S. 824 (1966).

The distinction between Section 60d and Section 64a(1) was noted in *In re David Bell Scarves*, 61 F.2d 771, 773 (2d Cir. 1932), *aff'd sub nom. Conrad, Rubin & Lesser* v. *Pender, supra*: "The former [section 60d] relates only to services to be rendered before bankruptcy is instituted, *In re Rolnick*, 294 F. 817 (C.C.A. 2); the latter [section 64(b) (3)] in general to services after petition is filed." See also 3A COLLIER, *op. cit. supra*, ¶ 60.68, p. 1143. Section 60d clearly does not authorize compensation to this petitioner. The refusal of the Court of Appeals to subvert this section can hardly be a basis for further review by this Court.

Petitioner's Contentions

In order to force an untenable construction of the foregoing statutes, and a departure from settled law, the petitioner portrays SIPC as a juggernaut against which the securities industry must be protected by financing attorneys who stand ready in its defense. Thus the petition asserts that SIPC seizes and impounds assets (pages 12 and 15); that without the payment of counsel fees SIPC would be possessed of "ex-parte" and "unfettered and unchallengeable" power to destroy livelihoods and reputations (page 13); that SIPC's opposition to financing petitioner "is raw abuse of power and discretion" (page 14); that SIPC has

"penalty and forfeiture powers" exercisable for mere technical violations of the securities laws (pages 14-15); and that the entire securities industry is in jeopardy of liquidation "on the initiative of SIPC" (pages 15-16). These remarks and the broad thrust of the petition are an unfortunate departure from the realities of law and fact. Response seems unnecessary beyond a few observations and referring the Court to the annexed Appendix.

SIPC is not a government agency nor does it have regulatory or investigative power. Neither does it have power to liquidate a broker-dealer. It merely has the authority to initiate a proceeding analogous to an involuntary proceeding in bankruptcy. This Court is respectfully referred to the companion decision in this case in which the Court of Appeals, consistent with SIPC's own views, outlined the procedures and burden of proof which must be met before a court will authorize the liquidation of a broker-dealer under the 1970 Act. *Securities and Exchange Commission* v. *Alan F. Hughes, Inc.*, 461 F.2d 947 (2d Cir. 1972). In substance that Court held that where a broker-dealer resists liquidation, a court must not only find the existence of at least one of the conditions specified in Section 5(b)(1)(A) of the 1970 Act [15 U.S.C. § 78eee(b)(1)(A)] (*e.g.* insolvency, act of bankruptcy, insufficient net capital), but based thereon it must also confirm SIPC's determination that the broker has failed, or is in danger of failing, to meet its obligations to its securities customers. Once the adjudication is made that the firm's customers require the protection of the 1970 Act, and that the business of the firm must therefore be liquidated, the matter proceeds under the aegis of a court-appointed liquidating trustee who, like any trustee under the Bankruptcy Act, is accountable to the court and subject to its supervision. The

ability of a broker-dealer to resist a proceeding initiated by SIPC is no less than that of a broker-dealer confronted by an involuntary petition in bankruptcy before the 1970 Act, or a broker-dealer so confronted today where the 1970 Act does not apply, or any other subject of involuntary bankruptcy proceedings.

Petitioner also seeks to create an appeal for his views by emphasizing that SIPC's funds are derived from assessments on brokers and dealers. Somewhat similarly, in the court below he unsuccessfully urged that Section 64a(1) could be expanded for his benefit in proceedings under the 1970 Act on the erroneous assumption that the availability of SIPC funds would not adversely affect the rights of customers and general creditors. In addition to the most adequate response of the Court of Appeals (page 404), it should be noted that administrative expenses in these proceedings continue to be a first priority burden upon a debtor's entire estate pursuant to Section 64a of the Bankruptcy Act. Any *advance* of SIPC funds for that purpose is reimbursable to it under Section 6(c)(2)(B)(ii) of the 1970 Act [15 U.S.C. § 78fff(c)(2)(B)(ii)]. The SIPC fund is designed to serve specified statutory purposes in a liquidation proceeding as provided in Section 6(f) of the 1970 Act [15 U.S.C. § 78fff(f)]. The payment of this petitioner's fees is clearly not among them.

As the Court of Appeals held (at page 404), there is no basis upon which to conclude that when it incorporated Section 64a(1) of the Bankruptcy Act "Congress intended to exclude well-settled judicial interpretations of that section." Indeed, the policy against depleting estates by compensating attorneys who unsuccessfully resist involuntary

proceedings finds greater support in proceedings under the 1970 Act. That legislation is intended to protect customers. Unsuccessful contests may well tie up their securities in a fluctuating and perhaps volatile market. Attorneys who contest successfully will be paid by the client. And regardless of success, prudent retainers have the protection of Section 60d. As the Court of Appeals properly noted (page 403), the representation of debtors resisting involuntary proceedings under the Bankruptcy Act "is a frequent phenomenon".

II.

There are no constitutional questions properly before this Court, and in any event the petitioner's constitutional arguments lack substance.

As the Court of Appeals observed (page 403), neither the Debtor nor its principal was deprived of any legal services throughout this proceeding. Nor was the Debtor deprived of due process of law in any other respect. *Securities and Exchange Commission* v. *Alan F. Hughes,* 461 F.2d 974 (2d Cir. 1972). What is therefore at issue in this case is the right of counsel to be paid, and not the Debtor's right or ability to defend.

In the Court of Appeals this respondent contended there was no justiciable controversy relating to the Debtor's constitutional rights, and that if the statutory scheme has any potential for constitutional issues relating to legal representation the resolution of such issues should await the proper case. See, *e.g., Sierra Club* v. *Morton,* 405 U.S. 727 (1972); *Jennings* v. *Mahoney,* 404 U.S. 25 (1971); *Association of Data Processing Service Organizations, Inc.* v. *Camp,* 397 U.S. 150, 152 (1970); *Golden* v. *Zwicker,* 394

U.S. 103, 108-109 (1969); *Thorpe* v. *Housing Authority of City of Durham*, 393 U.S. 268, 284 (1969); *Flast* v. *Cohen*, 392 U.S. 83, 94-101 (1968). Although the Court of Appeals recognized that the Debtor had been accorded its full measure of constitutional rights, it nevertheless also rejected the constitutional arguments on the merits. For the purpose of this petition it seems unnecessary to supplement that Court's rationale beyond noting that similar contentions were rejected in *In re Evenod Perfumer, Inc.*, 67 F.2d 878, 879 (2d Cir.), *cert. denied*, 291 U.S. 671 (1933). If a proper case arises it will then become necessary to consider the constitutional questions in light of the prevailing American rule governing the compensation of counsel in civil litigation [See, *e.g.*, *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 391-392 (1970); *Fleischmann Distilling Corp.* v. *Maier Brewing Co.*, 386 U.S. 714, 717 (1967); *Sprague* v. *Ticonic National Bank*, 307 U.S. 161 (1939)], as well as the plenary power of Congress in the field of bankruptcy including its constitutional authority to determine the extent to which fees may be allowed. See, *e.g. Reconstruction Finance Corp.* v. *Bankers Trust Co.*, 318 U.S. 515 (1943); *In re Chicago, M., St. P. and P.R. Co.*, 121 F.2d 371, 375 (7th Cir.), *cert. denied*, 314 U.S. 679 (1941).

In addition to his assertion of constitutional rights on behalf of the Debtor, the petitioner now states that through the statutes in question, as applied by the Court of Appeals, the Congress has taken his " . . . property right in his professional time spent on this case without just compensation." (Petition, page 14). This unsupported argument was not made in the Court of Appeals, and under well-settled principles of appellate review may not be advanced for the first time in this Court. In any event, the argument seems palpably specious. The petitioner rendered services volun-

tarily in the face of the statutes under discussion. The clarity of those statutes and related decisional law are matters with which he is chargeable. Even if there were uncertainty in their meaning and effect, he elected to take the attendant risks.

CONCLUSION

For the reasons stated above, the respondent respectfully submits that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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Securities Investor Protection Act of 1970

Purpose of 1970 Act

When the rate of stockbroker failures accelerated in the late 1960's and in 1970, Congress responded by enacting the Securities Investor Protection Act of 1970 ("1970 Act") whose several purposes were stated thusly in the Senate Committee Report:

> "... to protect individual investors from financial hardship; to insulate the economy from the disruption which can follow the failure of major financial institutions; and to achieve a general upgrading of financial responsibility requirements of brokers and dealers to eliminate, to the maximum extent possible, the risks which lead to customer loss." S.R. No. 91-1218, 91st Cong., 2d Sess. 4 (1970); see also H.R. No. 91-1613, 91st Cong., 2d Sess. 1 (1970).

The 1970 Act created the Securities Investor Protection Corporation ("SIPC") and, among other things, established new procedures for broker-dealer liquidations.

Status and Organization of SIPC

As this Court knows the securities industry is a self-regulated one over which the Securities and Exchange Commission ("Commission") has rulemaking and enforcement responsibilities. The regulatory function is essentially performed by the self-regulatory organizations, namely, the national securities exchanges and the National Association of Securities Dealers, Inc. The creation of SIPC was not intended to alter that system of self-regulation with Commission oversight, but rather to provide a vehicle within that system for the protection of customers of failed broker-dealers.

Under Section 3(a) of the 1970 Act[1] SIPC is organized as a nonprofit membership corporation, not an agency of the United States Government, with the powers and duties prescribed in the 1970 Act and those of a nonprofit corporation organized under the District of Columbia Nonprofit Corporation Act. Its business relates primarily to the protection of customers of broker-dealers in financial distress, in accordance with the substantive and procedural requirements of the 1970 Act.

The SIPC Board

Section 3(c)[2] establishes a seven-member Board of Directors which is vested with the responsibility to determine SIPC's policies (subject to Commission oversight, discussed below). The Secretary of the Treasury and the Federal Reserve Board each designate a director from among their respective officers and employees, and the President of the United States appoints (subject to Senate confirmation) the remaining five directors, three of whom must be selected from the securities industry and two from the general public. This provision not only reflects the self-regulatory character of the industry, but also takes into account the public interest and the potential exposure of one billion dollars of public funds (discussed below).

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[1] 15 U.S.C. § 78ccc(a). For convenience, references in the text to sections not otherwise identified are to sections of the 1970 Act. Similarly, footnote references not otherwise identified are to 15 U.S.C.

[2] § 78ccc(c).

SIPC's Members

The cost of providing protection to customers under the 1970 Act was intended to be borne by the industry itself. This was accomplished by mandating membership in SIPC for all broker-dealers registered under the Securities Exchange Act of 1934 ("Exchange Act") and all persons who are members of a national securities exchange, with certain exceptions, as provided in Section 3(a)(2).[3] However, the 1970 Act does not confer on the membership any rights to determine, or vote with respect to, the policies or operations of SIPC. Nor do they have such rights under the laws of the District of Columbia which, as applied to SIPC, vest all voting power and authority in the Board of Directors [D.C. Code § 29-1016 (d)]. In essence, SIPC membership is a device for establishing the liability of covered broker-dealers for the payment of assessments which provide the fund that protects customers. Except for their liability for assessments, Section 11(c)[4] specifically protects members from any liability as a member, among other things.

The SIPC Fund

The 1970 Act became law on December 30, 1970. Section 4[5] required SIPC to establish a "SIPC Fund" (to consist of cash, U. S. Government securities and confirmed lines of credit) of not less than 75 million dollars (less prior expenses) within 120 days from the enactment of the 1970 Act. It is a public fact that this was achieved *via* a 65 million dollar confirmed bank line of credit, with the

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[3] § 78ccc(a)(2).

[4] § 78kkk(c).

[5] § 78ddd.

remainder derived from stock exchange trust fund contributions and assessments on SIPC's members as provided in Section 4(c).[6]

Assessments

The amount of assessments on members of SIPC is prescribed by Sections 4(c) and (d).[7] Section 4(c)(2)[8] confers general assessment authority upon SIPC, including the power to vary assessments depending on relevant factors. The present assessment is the minimum required by Section 4(d)(1)(A)[9] until the SIPC fund aggregates not less than 150 million dollars.

Collection of Assessments

Although SIPC determines the rate or amount of assessments, the responsibility for collections from members of self-regulatory organizations rests with those organizations.

Under Section 8[10] each SIPC member is required to file certain financial information respecting its revenues so that its assessment liability can be ascertained. However, the member files that information with the "self-regulatory organization" which is the member's "examining authority" within the self-regulatory scheme.[11] Section 9(a)[12] des-

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[6] § 78ddd(c).

[7] §§ 78ddd(c) and (d).

[8] § 78ddd(c)(2).

[9] § 78ddd(d)(1)(A).

[10] § 78hhh.

[11] "Self-regulatory organization" and "examining authority" are defined in Sections 12 (1) and (3) [§§ 78lll(1) and (3)]. If a broker-dealer is not a member of any self-regulatory organization, it must file the information with the Commission which, in such circumstances, would be its "examining authority".

[12] § 78iii(a).

ignates the responsible "examining authority" as agent for the collection of assessments, and further provides for direct remittance to SIPC by the small number of broker-dealers who are not members of any self-regulatory organization. Assessments received by the self-regulatory organizations are transmitted to SIPC.

U. S. Treasury Funds

The 1970 Act recognizes that a dire crisis in the securities industry could well exhaust the SIPC Fund. To guard against that contingency a borrowing of one billion dollars from the U.S. Treasury is authorized in accordance with procedures set forth in Sections 4(g) and (h).[13] Such a borrowing is effected through the Commission which must itself determine that the loan is necessary for the protection of customers, among other things. Repayment by SIPC and its members is contemplated, and provision is made whereby the normal annual assessments received from members can be augmented.

SIPC's Role in Self-Regulatory Scheme

Except for a few limited powers granted to SIPC with respect to the self-regulatory organizations in areas of immediate interest to SIPC [Sections 9 (c) and (d)],[14] SIPC's role is one of consultation and cooperation with the self-regulatory organizations as provided in Section 9(e).[15] The self-regulatory organizations remain subject to the federal securities laws and the rules of the Commission.

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[13] §§ 78ddd(g) and (h).

[14] §§ 78iii(c) and (d).

[15] § 78iii(e).

Commission Oversight

The 1970 Act grants the Commission considerable control over SIPC. The Commission is vested with authority by Sections 3(e)(2) and (3)[16] to approve or reject any bylaw or rule adopted by SIPC's board, and indeed to require the amendment or rescission of any bylaw or rule adopted by SIPC. The Commission was also authorized to determine when SIPC shall phase out all confirmed lines of credit constituting a part of the SIPC Fund [Section 4(d)(2)(B)],[17] to approve SIPC's treatment of any trust funds which it might receive from any self-regulatory organization for purposes of reducing assessments [Section 4(e)(1)],[18] to determine whether the aforementioned borrowing from the U.S. Treasury is necessary [Section 4(g)],[19] to determine that the disclosure of any notice, report or other document filed with SIPC is not in the public interest [Section 11(a)],[20] and to determine the extent to which the provisions of the 1970 Act shall apply to the foreign operations of a SIPC member [Section 11(b)].[21]

In addition to its oversight of SIPC management and operations, the Commission is further authorized to adopt rules varying the 1970 Act insofar as it defines specifically identifiable property which must be returned to customers [Section 6(c)(2)(B)(iii)],[22] and to prescribe which open

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[16] §§ 78ccc(e)(2) and (3).

[17] § 78ddd(d)(2)(B).

[18] § 78ddd(e)(1).

[19] § 78ddd(g).

[20] § 78kkk(a).

[21] § 78kkk(b).

[22] § 78fff(c)(2)(B)(iii).

contractual commitments between the liquidating broker-dealer ("debtor") and other broker-dealers will be completed by the trustee in liquidation [Section 6(d)]."[23] In fact the Commission has exercised that power by promulgating Rules 15c3-3(j) and S6d-1 [17CFR 240.15c3-3(j); 17CFR 240.206d-1].

A major grant of authority and oversight to the Commission is contained in Section 7(b)[24] which authorizes the Commission to commence suit against SIPC to require it to discharge its obligations under the 1970 Act in the event SIPC refuses to commit its funds or otherwise to act for the protection of customers. The 1970 Act grants additional powers to the Commission which need not herein be enumerated.

Customer's Rights Pre-1970 Act

Prior to 1938 customers of a stockbroker in bankruptcy were entitled to the return of their securities and cash which could be traced as their property; as to such property their rights were superior to the claims of general creditors. See, *e.g., Duel* v. *Hollins,* 241 U.S. 523 (1916); *Gorman* v. *Littlefield,* 229 U.S. 19 (1913); *Richardson* v. *Shaw,* 209 U.S. 365 (1908); *Sexton* v. *American Trust Co.,* 45 F. 2d 372 (8th Cir. 1930); see, also, 3 Collier on Bankruptcy ¶ 60.72, pp. 1159-1165 (14th ed. 1971). However, the rights of customers *inter se* varied to some extent from jurisdiction to jurisdiction and there arose some inequality in the treatment of customers. See *Tepper* v. *Chichester,* 285 F. 2d 309, 311 (9th Cir. 1960); *In re McMillan, Rapp & Co.,* 123 F. 2d 428, 431 (3d Cir. 1941); 3 Collier, *op. cit. supra,* ¶¶ 60.72, 60.73, pp. 1159-1165, 1168 n.10.

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[23] § 78fff(d).

[24] § 78ggg(b).

As part of the Chandler Act, in 1938 Congress enacted Section 60e of the Bankruptcy Act [11 U.S.C. § 96(e)] in order to achieve greater equality of treatment of customers. That Section permitted cash customers, *as defined,* to reclaim cash or securities which could be specifically identified as their property within the statutory definition. Otherwise, it provided that cash, securities or property of similar character held for customers (but not specifically identifiable to particular customers) would be a "single and separate fund" to be applied in satisfaction of customer claims (other than for specifically identifiable property) on a *pro rata* basis. These customer claimants were described as a "single and separate class of creditors". Such a claim was for the "net equity" of his account, determined by subtracting the customer's indebtedness to the broker from the sum the broker would have owed the customer had the customer's securities (other than specifically identifiable property) and securities commitments been liquidated on the date of bankruptcy. Except for specifically identifiable property, customers were entitled only to a ratable participation in the "single and separate fund". As for the unpaid balance of their net equities, they were included among general creditors. A more detailed discussion of Section 60e may be found in 3 COLLIER, *op. cit. supra,* ¶¶ 60.72-60.76, pp. 1166-1201.

CUSTOMER PROTECTION UNDER 1970 ACT

SIPC is not an insurer in the usual sense. Its role is carefully delineated by the 1970 Act which establishes special procedures for the liquidation of financially distressed broker-dealers which are members of SIPC. Briefly, the statutory scheme works like this.

Nature of SIPC Proceeding

Under Section 5(a)(1),[25] if the Commission or any self-regulatory organization believes that a broker or dealer subject to its regulation is in, or is approaching, financial difficulty, it must immediately notify SIPC. Under Section 5(a)(2),[26] if SIPC determines that a member broker-dealer has failed or is in danger of failing to meet its obligations to customers, and that one or more of certain statutory conditions exist (for example, insolvency), it *may* apply to the appropriate federal district court for an order adjudicating that the customers of such member need the protection of the 1970 Act. If SIPC's determination is unchallenged, or sustained after contest, the court is required to issue a decree adjudicating that the firm's customers require protection, and appointing a trustee and counsel designated by SIPC for the liquidation of the firm's business.

A proceeding under the 1970 Act is a liquidation proceeding; reorganization is specifically prohibited [Sections 6(a) and (c)(1)].[27] The trustee has the same powers as a trustee in bankruptcy and a trustee under Chapter X of the Bankruptcy Act, and provision is made for the applicability of Chapter X of the Bankruptcy Act and certain provisions (other than Section 60e) of Chapters I to VII of the Bankruptcy Act [Sections 6(b) and (c)(1)].[28] The proceeding not only disposes of claims of customers, but also the claims of general creditors. Section 6(e)[29] provides for

[25] § 78eee(a)(1).

[26] § 78eee(a)(2).

[27] §§ 78fff(a) and (c)(1).

[28] §§ 78fff(b) and (c)(1).

[29] § 78fff(e).

prompt notice to customers and for their filing of claims within a specified time.

Customers' Rights Under the 1970 Act

Although it made some important changes the 1970 Act substantially tracked the provisions of Section 60e of the Bankruptcy Act [S.R. No. 91-1218, 91st Cong., 2d Sess. 11 (1970); H.R. No. 91-1613, 91st Cong., 2d Sess. 10 (1970)]. Thus customers are entitled to the return of their specifically identifiable property, as defined in Sections 6(a)(1)(A) and (c)(2)(C)[30] and the Commission's Rule 15c3-3 (j). Section 6(c)(2)(B)[31] continues the concept of a "single and separate fund" available for the satisfaction of the "net equity" claims of customers who are regarded as a single and separate class of creditors entitled to share ratably in such fund. The net equities of customers are computed as of the date SIPC initiates the liquidation proceeding, or an earlier date if the SIPC proceeding was preceded by (1) the filing of a petition in bankruptcy by or against the broker-dealer, or (2) a proceeding against the broker-dealer in which a receiver, trustee or liquidator was appointed [Sections 5(b)(4)(B) and 6(c)(2)(A)(iv)].[32] The applicable date is called the "filing date."

The total subject matter of Section 60e of the Bankruptcy Act is covered in Section 6(c)(2),[33] and as noted earlier the former Section is specifically made inapplicable thereby limiting its utility to failed firms whose judicial liquidations, for one reason or another, are not effected under the 1970 Act.

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[30] §§ 78fff(a)(1)(A) and (c)(2)(C).

[31] § 78fff(c)(2)(B).

[32] §§ 78eee(b)(4)(B) and fff(c)(2)(A)(iv).

[33] § 78fff(c)(2).

Completion of Open Contractual Commitments

As already stated (*supra*, page 1a) one of the broad purposes of the 1970 Act was "to insulate the economy from the disruption which can follow the failure of major financial institutions." Thus, Congress sought not only to protect customers of the debtor, but also to provide a measure of indirect protection to customers of other brokers and dealers doing business with the debtor. This was done *via* Section 6(d)[34] and the Commission's Rule S6d-1 thereunder authorizing the trustee to complete certain open contractual commitments between the debtor and other brokers and dealers.

Use of SIPC Funds to Satisfy Customer Claims

As already indicated customers file claims with the trustee who determines their validity. This is a claims program on an expedited basis. If a customer has a valid claim for securities, the trustee delivers those securities to the extent they are available after making any necessary or permissible allocation among customers claiming the same securities [Sections 6(c)(2)(B)-(D), 6(e) and 6(g)].[35] A cash payment from the single and separate fund is made in lieu of missing securities based on "filing date" values. Of course, claims for cash are payable in cash.

As a supplement to the assets in the trustee's hands, Section 6(f)[36] requires SIPC to advance funds to the trustee for the purpose of satisfying customers' net equity claims. However, SIPC may not advance more than $50,000 per customer of which not more than $20,000 may be for

[34] § 78fff(d).

[35] §§ 78fff(c)(2)(B)-(D), fff(e) and fff(g).

[36] § 78fff(f).

that portion of a customer's claim which is for cash, as distinct from securities. Not only is there a limitation upon the amounts available from SIPC, but it is also provided that SIPC funds are not available to satisfy claims of certain customers. Thus Sections 6(f)(1)(C) and (D)[37] prohibit the use of SIPC funds for certain principals of the debtor as well as claims of other brokers or dealers or banks not involving transactions for their customers.

Under Section 6(f)(2)[38] SIPC must also advance funds to complete certain open contractual commitments between the debtor and other broker-dealers, and may also do so for certain administrative expenses of the proceeding.

SIPC's Recoupment of Funds

As the foregoing demonstrates, SIPC does not simply pay claims as would an insurer. Moreover, its advances of funds are recouped from the debtor's assets to the full extent possible. Under Section 6(f)(1)[39] SIPC is subrogated to the rights and priorities of customers under the 1970 Act to the extent of its advances. Those rights are not only against the single and separate fund, but also against the debtor's general estate [Section 6(c)(2)(B)[40]]. In addition, funds advanced by SIPC for administrative expenses are recouped from both the general estate and the single and separate fund, to the extent assets are available (*Ibid.*). Such expenses enjoy priority under Sections 64a (1) and (2) of the Bankruptcy Act. [11 USC §§ 104a(1) and (2)].

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[37] §§ 78fff(f)(1)(C) and (D).

[38] § 78fff(f)(2).

[39] § 78fff(f)(1).

[40] § 78fff(c)(2)(B).